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Pension World

The Magazine for Plan Sponsors and Investment Managers/ A Publication of Communication Channels, Inc.

YMCA Retirement Fund Automates Its Reports

How Well Have Institutional Portfolios Performed?

Software Update

Pension World

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United Kingdom considers Additional Voluntary Contribution plans

As an American working and living in the U.K. since 1977 as an employee benefit and compensation consultant, I felt the need to respond to the article, "Do defined contribution plans make sense abroad?" [International Pension World] in the June 1985 issue of *Pension World*.

It appears to me that the authors, two U.S.-based international consultants, are suggesting that "more and more [U.S.] companies are considering the use of defined contribution retirement plans as either a supplement to or a replacement for defined benefit pension plans." They say that "a combination of persistence and, most important, excellent communication to local management and employees will lead to the successful establishment of [defined contribution] plans that are workable and well received by employees [in Europe]."

In their article they examine the possibility for establishing salary reduction 401(k)-type plans in the United Kingdom and Germany. At this time I shall only comment on their remarks about the U.K.

We in the U.K. are not adverse to the "exportation" of concepts and other ideas from the States. As a matter of fact, we even get "Dynasty" and "Dallas" on our television screens.

Their article mentions the fact that there is an opportunity here in the U.K. for employees to contribute up to 15 percent of pay to additional voluntary contributions (AVC) under Inland Revenue-approved retirement plans ("schemes" are what we call plans in this country). They did omit the fact that there is also available an opportunity in the UK for salary sacrifice plans with Inland Revenue approval which is also very rarely taken up in the U.K. (I will not go into salary sacrifice plans in the U.K. at this time.)

Average Contribution Rates for Pension Schemes

	Staff Schemes	Work Schemes	Combined Schemes
Employer			
Noncontributory schemes	17.2%	6.8%	16.0%
Contributory schemes	12.0	7.3	10.5
Employee	4.5	3.6	4.6

The average U.K. pension scheme member already contributes between 3.6 and 4.5 percent of pay, and U.K. employers are already making substantial contributions to pension schemes.

I would now like to return to their comments on AVCs. They indicate that although most approved plans offer the AVC option, "the participation rate is often less than five percent because the majority of lower-paid employees cannot afford to contribute to a voluntary plan." They suggest that "to improve participation—and encourage middle-level and lower-paid workers to save—companies could offer to match employee contributions." It is the term "save" that I believe the two gentlemen may have misunderstood in suggesting AVCs.

Before going on to the point about savings, let's look at the "1984 Tenth Annual survey of Occupational Pension Schemes" by the National Association of Pension Funds, which covered companies with approximately 6.9 million employees, 4.9 million of whom were members of pension schemes. This survey indicates that 89 percent of the schemes surveyed allowed members to make additional voluntary contributions (AVC) but that only eight percent of members of such schemes made voluntary contributions.

Now let's return to that word "save" and the suggestion that the employer match employee contributions to improve participation. Again returning to the NAPF survey, we find that unlike the U.S., where I believe the majority of pension plans are non-contributory, in the U.K. 79 percent of all schemes surveyed (covering 89 percent of all members) employees were already contributing. The average contribution rates, expressed as a percentage of salary, were as shown in the accompanying table. As can be seen from the table, the average U.K. pension scheme member already contributes between 3.6 and 4.5 percent of pay—not to mention the fact that U.K. employers are already making substantial contributions to pension schemes. In my view, the U.K. employer must be competitive in world markets and would not wish to increase his costs at this time by matching AVC employee contributions.

Another point that should be

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mentioned is the fact that about 63 percent of all personal savings in the U.K. is already in the form of contributions to pension and life insurance funds and 32 percent goes into house purchase.

Now let's return to the point about using AVCs as "savings." It is true that AVCs are tax-efficient as contributions by the employee are made from before-tax income, subject to a contribution limit of 15 percent of taxable income, and that invested assets also accumulate free from all forms of taxation.

Having said that, I note that three very important features, which in my view make AVCs unattractive as a "savings" vehicle, were omitted from the June 1985 article.

1. It is a requirement of Inland Revenue that a member's contribution, once established, *must* be maintained at a fixed rate (in monetary terms or fixed percentage of salary). The rate can be raised up to the maximum but *cannot* be lowered or stopped within five years from the date the plan was begun or last amended, except in the case of genuine financial hardship.

2. AVC benefits *must* be drawn at the same time as standard benefits. This means of course that AVCs are *only* available at retirement—either early or normal.

3. The maximum benefit that Inland Revenue normally will approve includes any benefit purchase by AVCs.

I believe we here in the U.K. may welcome "savings plans," but most of us are convinced that at the present time no "combination of persistence and, most important, excellent communication to local management and employees will lead to a successful establishment of [AVC] plans" in the U.K.

Although some people here in the U.K. may welcome "Dynasty" and "Dallas" as "exports" from the States, we do, however, question whether AVC is the correct approach to savings plans in the U.K. □

(Mr. Simone reports that under new legislation proposed in the U.K., all private pension schemes must *permit members the opportunity to elect Additional Voluntary Contributions. The legislation is part of the U.K. Government's attempt to reform its Social Security system.—Ed.)*

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